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SUBJECT: A NEW CHINESE EXPORT

¶1. Summary: Emerging as the sixth largest source of engineering contractors in the world, China's construction industry is seeking to increase exports of these services to Thailand. An experienced Chinese industry executive spoke candidly regarding his company's difficulties in navigating the disparate layers of Thai bureaucracy, asserting that Chinese construction firms are often outmaneuvered by more established Thai and foreign firms. However, others have complained the companies receive undue support from the Chinese government, including low-interest loans and direct grants. Finally, it appears that most members of Thailand's construction industry support caretaker PM Thaksin Shinawatra's government, as it provided political stability and maintained important existing contacts. End summary.

¶2. As a close neighbor and a large developing market in Southeast Asia, Thailand has attracted the attention of Chinese construction firms as a destination for increased service exports. Currently the world's sixth largest exporter of engineering services, China's construction firms have relatively extensive foreign operating experience. At the 2006 Global Construction Summit in India, deputy president of the China International Contractors Association (Chinca) Diao Chunhe said Chinese firms in 2005 reached a record turnover of USD 21.76 billion globally, a 24.6 percent increase from ¶2004. New contracts signed by Chinese contractors in 2005 totaled USD 29.6 billion, also up 24.2 percent. Moreover, one Thailand-based Chinese industry source noted that the Chinese Ministry of Commerce has facilitated a shift from mostly African and Middle Eastern projects in the 1980s to increased emphasis on countries bordering China, including Southeast Asia, Mongolia and Russia.

A Chinese old Thai hand

¶3. Despite a growing international market and support from China's policy-makers, one Chinese executive fretted that Chinese construction companies still have difficulties in penetrating the Thai market. During a candid July 5 meeting, Mr. Wang Yinfei, managing director at China State Construction Engineering Company (CSCEC), provided Econoff with his perspectives on the evolving Chinese business and investment strategies in other countries. Wang is rare among prominent Chinese business leaders in that he is relatively young, well-experienced overseas and conversant in Chinese, Thai and English. Graduating from Shanghai's prestigious Fudan University, Wang first arrived in Thailand as a middle manager in 1988 for CSCEC. Since then he has spent all but one year living in Bangkok. His company was a founding member of the Chinese-Thai Enterprises Association, where Wang served as its first president.

¶4. Wang described the difficulties in receiving contracts in Thailand, a process of building personal networks at multiple levels of every ministry's staff and navigating through a complicated system of regulations. Wang claimed on certain projects Thai companies influence ministers to block competitors by withholding upgrades of technical rating certifications, necessary for larger, more lucrative contracts. This practice also infiltrates bid evaluations, which are divided into two categories: price and technical expertise. Although the different bid values are open, Wang deemed the technical evaluation an arbitrary process that often

depended on "personal connections", where Thai and more established foreign firms excel. Other limitations are requirements for joint-venture partnerships with Thai companies under Thai government procurement regulations. Mr. Lu Jiongtao, managing director for Chinese hydropower company CWE, noted that all of his company's projects required a Thai company as lead bidder. (Note: Chinese construction companies circumvent this by legally establishing themselves as Thai entities. End note.)

15. Wang also noted that corruption is endemic in the construction industry, a problem confirmed by Thai contractors as well. Still, all parties seemed to accept this condition as a standard operating expense. Mr. Thamnu Vasinonta, executive director for the Thai Contractors Association said he disliked the current practices of bribery, but interestingly not its principle. "A bribe should not be an assumed cost of doing business," he said, "but more like a tip companies give to show appreciation after the bidding." He implied that better government 'service' to efficiently award contracts deserved a bigger 'tip', and vice versa. Wang also conveyed that CSCEC also had to adapt to this reality, and one must "brainwash" away any notion of legal and administrative ethics. "You can't come to Thailand and expect to change the society," he remarked. Wang even joked about the relative transparency of corruption; the amount of the bribe is rarely arbitrary, but a similarly fixed percentage of the contract value.

Chinese construction companies: Pups or Wolves?

16. Despite these difficulties, Chinese construction firms and other service exporters have aggressively increased their presence in Thailand. Aside from the large communications company Huawei, BoI China desk director Mr. Charas Chitkittichamras listed construction firms CSCEC, CHEC and CITIC as the most prominent players. He

BANGKOK 00004888 002 OF 003

explained that thus far they have generally received contracts for public housing complexes; for more complicated "megaprojects", Chinese companies usually play minor roles as subcontractors. Charas suggested that the primary reasons include a relative lack of capability and poor understanding of Thailand's bidding process.

17. Since 2001 Wang said CSCEC has improved relationships with different RTG ministries, winning the prime contractor role on a few projects. Wang said that his company's largest current contracts include an 8.4 billion baht (USD 220 million) housing project with 20,000 units and a 1 billion baht (USD 26 million) local government office tower, but he also added a 3.8 billion baht (USD 100 million) outer ring highway for Bangkok. He also confirmed other projects where CSCEC acted as a subcontractor, but he denied that CSCEC accepted subcontractor status because of any technical deficiencies.

Rather, he contended that his company wanted to avoid the complicated machinations in securing large projects from the Thai government.

18. Chinese companies have also started making inroads into contracts for pipelines and dams. For instance, the Petroleum Authority of Thailand (PTT) recently chose Chinese Petroleum Pipeline Engineering Corporation (CPPE), a subsidiary of the China National Petroleum Corporation (CNPC), to build a 70 kilometer pipeline near Bangkok that leads to the Wang Noi power plant. One Thai construction expert from U.S. engineering giant Bechtel confirmed the determination of Chinese companies to advance their own processes, materials and information. For example, the Chinese CPPE subcontractor has asked Bechtel repeatedly for copies of information on unrelated construction projects. "The Chinese are learning all the time," the Bechtel representative noted, "and they're learning quickly." Eventually he expects these companies to be very competitive.

19. In almost every case, Chinese construction and service providers offer the lowest prices as their primary advantage, and Charas noted that sometimes their bids are half of its competitors. Part of this advantage may stem from their tendency to use only Chinese suppliers, traders and even labor. Andy Huang, president of Taiwanese construction firm Sunflower Group, complained about

Chinese companies accepting smaller payments in installments, sometimes with no up front payment, because of PRC financial assistance. CSCEC's Wang confirmed the practice, although his rationale differed from Huang's, citing his firm's more flexible payment option as a response to ministry budget shortfalls.

¶10. These activities have some observers questioning whether Chinese companies are playing fair. For example, Charas believed that Chinese companies lack many of the technical capabilities to compete for major contracts. However, the Bechtel source noted that Chinese companies are sometimes selected despite being less qualified than other competitors. He suggested that the PTT is "heavily influenced" by the Thai Ministry of Commerce, which in turn is susceptible to Chinese influence through inter-government loans. Although the evaluated Chinese bid on the pipeline project was the cheapest, CPPE had the weakest qualifications, material support and expertise. As project manager on behalf of the RTG, Bechtel also has had to exert extra effort to administer the contract to ensure CPPE does not cut corners.

¶11. Wang freely acknowledged that the Chinese government has ratcheted up its support for outbound investments, including very low-interest loans and liberal re-import/export policies that allowed Chinese firms to transport their equipment and machinery from China to Thailand. Even Thai contractor association representative Thamnu agreed that some level of outside influence is acceptable, but he balked at direct PRC loans to Chinese companies. That type of advantage would create overtly unfair bidding conditions. As an alternative, Thamnu thought that the Chinese government should make more government-to-government loans for construction projects, with the caveat that Chinese companies receive preferential access. He suggested that this would help to maintain fairness for existing projects while giving Chinese construction more opportunities for previously unbudgeted works, something of a win-win for everyone.

Politics and the waiting game

¶12. Thailand's current political uncertainties have reduced the overall level of construction, particularly for public-funded projects. Thamnu suggested that members of his organization, which is unaffiliated with any government or political entity, have watched both new and existing contracts halted. Funding has crawled to a standstill as the government lacks power to approve new budgets. Lu noted that CWE will have no new projects for at least 6 months and can do nothing but wait. Perhaps as a result, Thamnu expressed his personal view that the Thaksin government had been good for contractors.

¶13. Wang also believed most Chinese companies supported the current Thaksin government and the Thai Rak Thai (TRT) party because it generally advanced pro-business economic policies. While

BANGKOK 00004888 003 OF 003

acknowledging Thaksin's special emphasis on Chinese trade and investment has been helpful, he said the primary reasons for growing Chinese business activities go beyond a cultural affinity with the large ethnic Chinese Thai business elite. Wang liked Thailand's Buddhist mores, but political stability since 2001 has been the main draw for further trade. This is magnified in an industry like construction that requires strong business-government relations. He did not object to the opposition Democrat Party except for continuity's sake. He gave an example of CSCEC's local government office building suffering delays and higher costs when the Democrat Party took power and demanded significant changes to the project design and materials.

¶14. Comment: The construction industry is an example of Chinese potential to expand their growing exports to Southeast Asia beyond traditional sectors involving cheap goods and agricultural products. While China does not yet export highly-skilled services in finance or consulting, its low-cost construction SOEs may prove formidable competitors once they better navigate Thailand's construction networks. We note that none of the Chinese construction firms discussed competing for private sector construction contracts

despite their apparent pricing competitiveness. End Comment.

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